

BEFORE THE TENNESSEE STATE BOARD OF EQUALIZATION

IN RE: Interchange Distribution Ltd.)
Ward 093, Block 400, Parcel 00412C) Shelby County
Industrial Property)
Tax Year 2006)

INITIAL DECISION AND ORDER

Statement of the Case

The subject property is presently valued as follows:

<u>LAND VALUE</u>	<u>IMPROVEMENT VALUE</u>	<u>TOTAL VALUE</u>	<u>ASSESSMENT</u>
\$330,600	\$4,773,900	\$5,104,500	\$2,041,800

An appeal has been filed on behalf of the property owner with the State Board of Equalization. The undersigned administrative judge conducted a hearing in this matter on June 20, 2007 in Memphis, Tennessee. In attendance at the hearing were registered agent Jim Schwalls and Shelby County Property Assessor's representative Rick Middleton, TCA.

FINDINGS OF FACT AND CONCLUSIONS OF LAW

Subject property consists of an 8.94 acre tract improved with a 177,972 square foot distribution warehouse constructed in 1996 located at 5465 Raines Road in Memphis, Tennessee. Subject property had been leased in its entirety to Wiremold Co. for \$3.73 per square foot until it vacated the property in 2005. The taxpayer subsequently leased 60,000 square feet to FDL, Inc. on October 1, 2005 for \$2.70 per square foot. The remainder of the warehouse is vacant.

The taxpayer contended that subject property should be valued at \$4,290,000. In support of this position, the income approach was introduced into evidence. Mr. Schwalls maintained that the indicated stabilized value of \$4,821,818 should be reduced by \$527,300 to account for rent loss during the two year lease-up period necessary to achieve stabilized occupancy of 90%.

Mr. Schwalls also noted in his analysis that subject property was purchased on March 9, 2006 as part of a six property acquisition for \$4,300,000. Mr. Schwalls asserted that “the excess vacancy was recognized in the purchase price and is a fair indicator of market value as of January 1, 2006.

The assessor contended that subject property should be valued at \$4,924,800 based upon the income approach. Mr. Middleton essentially argued that a deduction for lost rent during the lease-up period is unnecessary because his income approach has been adjusted to reflect the admitted occupancy problem.

Mr. Middleton also asserted that comparable sales support his contention of value. In support of this position, Mr. Middleton included in his analysis (exhibit #2) summaries of several comparable sales.

The basis of valuation as stated in Tennessee Code Annotated Section 67-5-601(a) is that "[t]he value of all property shall be ascertained from the evidence of its sound, intrinsic and immediate value, for purposes of sale between a willing seller and a willing buyer without consideration of speculative values . . ."

After having reviewed all the evidence in the case, the administrative judge finds that the subject property should be valued at \$4,364,600 in accordance with the following income approach:

Potential Gross Income (177,972 SF @ \$2.75)	\$ 489,423
Less Vacancy & Credit Loss (10%)	- 48,942
Effective Gross Income	\$ 440,481
Less Expenses (12¢ per SF) & Reserves (10¢ per SF)	- 39,154
Net Operating Income (NOI)	\$ 401,327
NOI Capitalized at 8.25%	÷ .0825
Indicated Stabilized Value	\$4,864,570
Less Lease-up	- 500,000
Final Value:	\$4,364,570

The administrative judge finds that the parties' contentions of value prior to lease-up differ by a relatively insignificant 2% (\$4,821,818 vs. \$4,924,800). The administrative judge finds that the primary difference between the parties' income approaches concerned whether reserves should be accounted for in expenses or via the capitalization rate. The administrative judge finds that both approaches are acceptable. The administrative judge finds it preferable in this particular case to account for reserves as part of expenses. The administrative judge finds that the advantage of this approach is reserves are quantified as a standalone item rather than as part of a composite rate.

The only other difference between the parties' income approaches prior to lease-up concerned market rent (\$2.70 vs. \$2.86 per SF). The administrative judge finds that the preponderance of the evidence supports adoption of a market rental rate of \$2.75 per square foot.

The critical difference between the parties' contentions of value pertained to the issue of lost income during the lease-up period necessary to achieve stabilized occupancy. The administrative judge finds that Mr. Schwalls' lease-up analysis comports with generally accepted appraisal practices. For example in *Kailes v. Josephine County Assessor* (TC-MD 982945C, 000613C) the Oregon Tax Court approved a similar analysis reasoning in pertinent part at page 6 of its opinion as follows:

Lost Rent

The Appraisal of Real Estate discusses rent loss in the context of a proposed multi-tenant project that is not fully leased. In that situation, the authors note that “[t]he appraiser should account for impact of the rent lost while the building is moving toward stabilized occupancy.” *Id.* At 590. Several approaches are set forth regarding how the appraiser can account for the loss of rent. One recommended technique is to “discount the net income loss during lease-up, which is then deducted from the value of the property at stabilized occupancy.” *Id.* Both of Plaintiff’s appraisers did just that. The amount each appraiser deducted differed because they used different lease-up periods (one year versus two). The court finds no practical reason why the same approach would not be valid for the subject building with no tenant(s), because each situation presents the same problem. The risk inherent with Plaintiff’s property is accentuated by the fact that it is a one or two tenant property.

As such, the absence of a tenant has a dramatic impact on income and, in a market with lengthy lease-ups, a significant impact on value.

The administrative judge finds unpersuasive Mr. Middleton’s assertion that his income approach adequately accounts for lost income due to low occupancy.

The administrative judge finds that the proof supports minor adjustments to Mr. Schwalls’ lease-up analysis. On the one hand, the administrative judge has adopted a slightly higher market rental rate which actually increases the amount of lost income. On the other hand, the administrative judge finds that the proof supports downward modifications to other components of Mr. Schwalls’ analysis. The administrative judge finds that net effect of the various adjustments equates to a net present value for rent loss and build-out of approximately \$500,000.

ORDER

It is therefore ORDERED that the following value and assessment be adopted for tax year 2006:

<u>LAND VALUE</u>	<u>IMPROVEMENT VALUE</u>	<u>TOTAL VALUE</u>	<u>ASSESSMENT</u>
\$330,600	\$4,034,000	\$4,364,600	\$1,745,840

It is FURTHER ORDERED that any applicable hearing costs be assessed pursuant to Tenn. Code Ann. § 67-5-1501(d) and State Board of Equalization Rule 0600-1-.17.

Pursuant to the Uniform Administrative Procedures Act, Tenn. Code Ann. §§ 4-5-301—325, Tenn. Code Ann. § 67-5-1501, and the Rules of Contested Case Procedure of the State Board of Equalization, the parties are advised of the following remedies:


1. A party may appeal this decision and order to the Assessment Appeals Commission pursuant to Tenn. Code Ann. § 67-5-1501 and Rule 0600-1-.12 of the Contested Case Procedures of the State Board of Equalization.

Tennessee Code Annotated § 67-5-1501(c) provides that an appeal **“must be filed within thirty (30) days from the date the initial decision is sent.”** Rule 0600-1-.12 of the Contested Case Procedures of the State Board of Equalization provides that the appeal be filed with the Executive Secretary of the State Board and that the appeal **“identify the allegedly erroneous finding(s) of fact and/or conclusion(s) of law in the initial order”**; or

2. A party may petition for reconsideration of this decision and order pursuant to Tenn. Code Ann. § 4-5-317 within fifteen (15) days of the entry of the order. The petition for reconsideration must state the specific grounds upon which relief is requested. The filing of a petition for reconsideration is not a prerequisite for seeking administrative or judicial review; or
3. A party may petition for a stay of effectiveness of this decision and order pursuant to Tenn. Code Ann. § 4-5-316 within seven (7) days of the entry of the order.

This order does not become final until an official certificate is issued by the Assessment Appeals Commission. Official certificates are normally issued seventy-five (75) days after the entry of the initial decision and order if no party has appealed.

ENTERED this 24th day of August, 2007.



MARK J. MINSKY
ADMINISTRATIVE JUDGE
TENNESSEE DEPARTMENT OF STATE
ADMINISTRATIVE PROCEDURES DIVISION

c: Mr. Jim Schwalls
Tameaka Stanton-Riley, Appeals Manager